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2       UNITED STATES BANKRUPTCY COURT  
3       SOUTHERN DISTRICT OF NEW YORK

4       -----x  
In Re:

Chapter 11

5       LEHMAN BROTHERS

Case No. 08-13555 (JMP)

6       HOLDINGS, INC., et al.,

(Jointly Administered)

7       -----)

8       \* \* \* HIGHLY CONFIDENTIAL \* \* \*

9       DEPOSITION OF PHILIP E. KRUSE

10      New York, New York

11      Thursday, December 17, 2009

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20     Reported by:

FRANCIS X. FREDERICK, CSR, RPR, RMR

21     JOB NO. 26533

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5 December 17, 2009

6 9:32 a.m.

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9 HIGHLY CONFIDENTIAL videotaped  
10 deposition of PHILIP E. KRUSE, held at  
11 the offices of Boies Schiller & Flexner,  
12 LLP, 575 Lexington Avenue, New York, New  
13 York, pursuant to Notice, before Francis  
14 X. Frederick, a Certified Shorthand  
15 Reporter, Registered Merit Reporter and  
16 Notary Public of the States of New York  
17 and New Jersey.

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2 just -- I'm trying to be careful as to what  
3 you're asking.

4 Q. Okay. The claim is that your  
5 current knowledge of the value of the fed repo  
6 collateral is privileged work product.

7 MR. TAMBE: No, that's not the  
8 position and that's why we're running  
9 into trouble here. You can have an  
10 understanding as to --

11 MR. THOMAS: No, I asked him what  
12 his current understanding was and he  
13 said --

14 MR. TAMBE: And there was an  
15 objection to that question.

16 MR. THOMAS: But he said it would  
17 have to be biased upon privilege worked.

18 MR. TAMBE: And the reason there  
19 was an objection to that question is you  
20 seem to be trying to get at is there  
21 independent valuation done by LBHI or  
22 A&M independent of information. There's  
23 lots of information on the record about  
24 values ascribed to that collateral. On  
25 and before the closing date. That's

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2 certainly within their understanding as  
3 to values ascribed by others. Okay. Go  
4 ahead.

5 MR. THOMAS: I'm not trying to --  
6 I know there's nominal marks that exist  
7 that he might have read in a paper or  
8 something else like that. I'm asking if  
9 Alvarez, prior to -- independent of what  
10 is being claimed as work product made  
11 any effort to value that collateral, the  
12 fed repo collateral.

13 A. No, we did not.

14 Q. Okay. What was Alvarez's  
15 understanding as to the value of the fed  
16 collateral prior to doing this work product  
17 with counsel?

18 A. Any understanding we had about  
19 values ascribed to the collateral would have  
20 been gained post closing and in connection  
21 with the gathering of data so that we  
22 understood the securities that were  
23 transferred in connection with the  
24 transaction.

25 Q. And as you sit here today can you

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2 tell me what that understanding was in terms  
3 of the amount of the fed repo collateral?

4 A. I think it would be more  
5 appropriate or perhaps more safe, rather than  
6 having me misstate a number, I'm thinking of  
7 e-mails that I know some of the A&M people  
8 were gathering the data and I think those  
9 documents represent what our early  
10 understanding was of the ascribed values.

11 Q. Okay. After the sale closed, what  
12 was the purpose of your trying to get an  
13 understanding of the value of the assets that  
14 had been transferred? Yours being Alvarez's.

15 A. It was really from the perspective  
16 of capturing the data that we thought was  
17 going to be necessary for us to administer the  
18 estate and understanding what was estate  
19 assets, what was not estate assets. I think  
20 there was some thought early on that we would  
21 try to do a reconciliation of the securities  
22 that were transferred, ensure that nothing was  
23 transferred that should not have been  
24 transferred under the deal.

25 That effort was not really

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2 feasible based on the information available to  
3 us in that first quarter of the administration  
4 of the estate.

5 But the context was ensuring we  
6 had the data in hand while it was fresh in  
7 everybody's mind as to what was transferred in  
8 the deal.

9 Q. Let me show you a document we'll  
10 mark as 461A.

11 (Deposition Exhibit 461A, document  
12 bearing production numbers AM 004503  
13 through AM 004595, marked for  
14 identification as of this date.)

15 BY MR. THOMAS:

16 Q. Is this a document that you've  
17 seen before?

18 A. Yes. I've seen this.

19 Q. And when did you see it?

20 A. When did I see it?

21 Q. Yes.

22 A. I would have first seen it pretty  
23 much contemporaneous with the date of this,  
24 October 8th, or the day or two before.

25 Q. And can you describe what the

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2 document is, please.

3 A. It is a Powerpoint dec assembled  
4 by Alvarez & Marsal to report to the Unsecured  
5 Creditors Committee on this date of October  
6 8th. It was sort of a guide for communication  
7 to the Unsecured Creditors at that point.

8 Q. And why was Alvarez & Marsal  
9 relaying this information to the Creditors  
10 Committee?

11 A. It was in the context of the  
12 Creditors Committee is an important  
13 constituent that we serve in the  
14 administration of the estate and giving them  
15 an early download as to our activities and how  
16 we're getting ramped up and getting ready to  
17 best serve our role as a chief restructuring  
18 officer.

19 Q. If I could ask you to turn to page  
20 28, please.

21 A. (Witness complies.)

22 MR. ROTHMAN: The Bates number or  
23 the page?

24 MR. THOMAS: That's the page  
25 number. The Bates number is AM 4531.

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2 Q. And let me just ask, who would  
3 have prepared this document?

4 A. Who physically prepared it?

5 Q. Yes. Or determined what went into  
6 the document.

7 MR. TAMBE: Object to the form.

8 Go ahead.

9 A. The document as a whole would have  
10 been a joint effort. I had some participation  
11 in a slide or two here as well. So, you know,  
12 depending on who you see as the leader or the  
13 discussion leader on a given subject that's  
14 likely the person who directed the  
15 preparation. The physical preparation was  
16 probably somebody working underneath that  
17 particularly person.

18 Q. Did Alvarez work with anyone at  
19 Lehman or Lazard or anyone other than Alvarez  
20 to pull this information together?

21 A. Not to my knowledge.

22 Q. Do you know who would have  
23 prepared the information that appears on page  
24 28 of the document?

25 A. I would presume Jim Fogarty was

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2 MR. TAMBE: He's given you his  
3 answer. And he's mentioned the GFS data  
4 now. So what else do you want him to  
5 talk about? He's told you the bases for  
6 his understanding.

7 MR. THOMAS: I want to make sure  
8 we close that out.

9 BY MR. THOMAS:

10 Q. So at this time, the time of this  
11 document, at the time you were making your  
12 presentation to the Creditors Committee, is it  
13 fair to say that Alvarez believed the Lehman  
14 marks were stale?

15 MR. TAMBE: Objection to the form  
16 of the question.

17 A. No. I don't think that's a fair  
18 characterization. I think this was the  
19 recitation of something that was communicated  
20 to us. I don't think we were making a  
21 qualitative assessment that it was accurate or  
22 inaccurate. We were simply communicating  
23 information to a key constituent of ours.

24 Q. Do you know who communicated that  
25 to Alvarez?

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2 A. I don't know specifically because  
3 I didn't get a chance to get a hold of Jim  
4 Fogarty in the last couple of days. He would  
5 be the better person to ask. But I infer from  
6 the documents I've seen Ian Lowitt or somebody  
7 that worked with Ian Lowitt.

8 Q. Okay. You're aware that --

9 A. I'm sorry. Did I say Ian Lowitt?

10 Q. Yes.

11 A. I believe it was Paolo Tonucci.

12 Q. You're aware that Barclays did not  
13 believe that the marks of the repo collateral  
14 were still accurate as of the time of closing,  
15 correct?

16 A. I'm sorry. Am I aware sitting  
17 here today that Barclays doesn't believe those  
18 marks were accurate?

19 Q. Right.

20 A. I understand that is an assertion,  
21 yes.

22 Q. Okay. In any event, Alvarez  
23 understood and communicated to the Committee  
24 that there was a difference in the value of  
25 the repo assets ascribed for purposes of the

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2 sales transaction and -- between that and  
3 the -- what's referred to here as the stale  
4 marks. The nominal marks on the fed repo  
5 collateral.

6 MR. TAMBE: Objection to the form  
7 of the question.

8 A. Sorry. I lost the train of that  
9 question. Could you repeat it?

10 Q. Okay. Alvarez understood and  
11 conveyed to the Committee at this time that  
12 there was a difference between the Lehman  
13 marks and the -- of the repo collateral and  
14 the value of the repo collateral ascribed to  
15 the repo collateral for purposes of the sale  
16 transaction by the parties.

17 MR. TAMBE: Object to the form of  
18 that question.

19 A. I think we've gone over this. You  
20 know, I think the words communicate that  
21 concept. I'm not necessarily agreeing that we  
22 accepted it at the time as being -- you know,  
23 I take this as Jim was relaying information  
24 that we had come to understand through others  
25 at that point. I don't think we were making a

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2 qualitative judgment at that point that it's  
3 right, wrong, or otherwise.

4 Q. Well, putting aside whether it's  
5 correct or not, that's what was being  
6 conveyed, though; that there was this  
7 difference between the old Lehman marks and  
8 the parties' valuation of the repo collateral  
9 for purposes of the sale transaction. That's  
10 what the reduction is referring to, correct?

11 MR. TAMBE: Object to the form of  
12 the question.

13 A. If I understand that correctly  
14 that's probably a fair characterization.

15 Q. Okay. Let me ask it open ended.  
16 What is the reduction that's -- the \$5 billion  
17 reduction referring to there?

18 A. What is it referring to?

19 Q. Yes.

20 A. Well, it's referring to apparently  
21 a negotiated difference between the value  
22 which the assets were acquired versus the way  
23 they were characterized prior to the  
24 transaction.

25 Q. And Alvarez would have tried to

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2 make its presentation to the Creditors  
3 Committee as accurate as it could, correct?

4 A. Yeah. We were certainly trying to  
5 convey accurate information to the committee.

6 Q. And Alvarez also understood that  
7 the -- if you look at the next bullet point --  
8 that the sale transaction conveyed to Barclays  
9 the unencumbered box?

10 A. Yes.

11 Q. And is the unencumbered box  
12 referring to the clearance box assets?

13 MR. TAMBE: Object to the form.

14 Go ahead.

15 A. Is unencumbered box relating to  
16 the -- unencumbered box I think refers to  
17 unencumbered collateral that was transferred  
18 that wasn't -- that didn't have a lien on it  
19 prior to the transaction.

20 Q. Would you take a look back at the  
21 clarification letter, please.

22 A. (Witness complies.)

23 Q. And if you would look at  
24 Section -- paragraph 1(a)(ii)(B).

25 A. Yes.

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2 though, is was that Alvarez's understanding at  
3 the time that Barclays was entitled to either  
4 the 769 million of the 15(c) (3) securities if  
5 permitted by law or if not permitted by law  
6 securities of substantially the same nature  
7 and value?

8 A. I'm not even sure I would go that  
9 far. In the context of what we were trying to  
10 accomplish at this time, you know, the  
11 intricacies of customer property and things  
12 that were probably under the purview at that  
13 time of LBI wouldn't have been a particular  
14 focus of ours. Obviously, it's here in the  
15 document that was provided to us. The degree  
16 to which Alvarez & Marsal focused on this or  
17 really thought about it or considered it, I  
18 wouldn't presume anything beyond that it's  
19 here on the document.

20 Q. Is it your understanding at least  
21 that that's what Weil was telling you was part  
22 of the deal?

23 A. Well, I think the document speaks  
24 for itself in terms of where it came from and  
25 what it says.

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2 Q. So as part of its -- about how  
3 many people at Alvarez were working on this  
4 effort to try to assess the transfers, the  
5 deal, during this period of time?

6 MR. TAMBE: Objection to the form  
7 of the question.

8 A. Difficult for me to characterize  
9 numbers of people. It was a substantial part  
10 of our effort at that point. I think as it  
11 relates to Barclays in particular, our focus  
12 was on, you know, bearing in mind, of course,  
13 that the business and all of its systems, its  
14 records, all of its systems, and substantially  
15 all of its employees were being moved over to  
16 Barclays. The TSA, the Transition Services  
17 Agreement, was the primary focus of ours as it  
18 related to Barclays at the time. And so the  
19 numbers of people -- there's within this  
20 October 8th dec I think there's some depiction  
21 of the numbers of people that we were gearing  
22 up with at that time. But a substantial  
23 portion of those people were involved in this  
24 effort across multiple asset classes and  
25 multiple teams that I think is probably best

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2 portrayed in this document at that time as  
3 opposed to me trying to recite that for you.

4 Q. When Alvarez became aware of the  
5 discount that we discussed and was in the  
6 presentation to the Creditors Committee, did  
7 Alvarez take any action or do anything with  
8 respect to the fact that there was a discount  
9 or a difference between the agreed value of  
10 the repo collateral and certain marks?

11 MR. TAMBE: Objection to the form.

12 A. No, again, I would characterize,  
13 you know, what we were doing at this time  
14 relaying information that had been given to us  
15 in connection with that transaction to our UCC  
16 constituency. Some aspects of which they may  
17 have known more than we did at the time  
18 because they had perhaps people involved as  
19 the deal was happening that weekend whereas we  
20 did not. Did we take action? This was not a  
21 priority at the time. We were not -- again,  
22 as it relates to Barclays, the TSA was our  
23 primary focus. Getting ourselves in a  
24 position where we could run the wind-down of  
25 this enormously large operation in a competent

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2 way, that was our focus.

3 Q. Did anyone at the Committee  
4 express any surprise that there was a  
5 difference between the agreed value of the  
6 marks as part of the transaction and some  
7 prior Lehman marks?

8 MR. TAMBE: Objection to form.

9 A. At this meeting? I think I  
10 covered that.

11 Q. At the meeting -- okay. Let's try  
12 it without the meeting.

13 A. I was not at the meeting so I  
14 can't offer any insight.

15 Q. You tricked me.

16 Okay. At any time to your  
17 knowledge.

18 A. Just to clarify, I was not at any  
19 part of the meeting so I can't offer any  
20 insight.

21 Q. At any time, to your knowledge.

22 A. At any time did -- I'm sorry. I  
23 just want to make sure I got your question  
24 straight. I've lost track.

25 Q. At any time did anyone, to your

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2 knowledge, from the Committee express, you  
3 know, surprise about the fact that there was a  
4 difference in the value of the fed repo  
5 collateral agreed to by the parties for  
6 purposes of the deal and the -- some nominal  
7 prior Lehman marks?

8 MR. TAMBE: Objection to form.

9 A. You mean people sitting on the  
10 Committee? I didn't have a lot of  
11 communication with people sitting on the  
12 Committee.

13 Q. That may be so but are you aware  
14 of anyone on the Committee expressing surprise  
15 about the fact that there was this delta?

16 A. Not that I'm aware. Again, there  
17 may have been communications I'm not aware of.

18 Q. Are you aware of anyone else who  
19 expressed surprise or indicated that that was  
20 news to them? Anyone at Alvarez or LBHI or  
21 anyone at this period of time?

22 MR. TAMBE: Objection to form.

23 A. My recollection during the first  
24 quarter of our administration of the estate,  
25 there was a gentleman from Houlihan, I believe

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2 Mike Fazio, who I think primarily indirectly  
3 through others I understood that he was  
4 expressing some concerns about the economics  
5 of the deal and whether it was ultimately in  
6 the best interest of the estate to have the  
7 deal done as it was papered. I -- you know.

8 Q. Can you think of anything else  
9 other than that?

10 A. Not that I recall.

11 Q. Was Mr. Fazio's expression of  
12 concern more general or particularly with  
13 respect to there being a delta between the  
14 agreed value of the -- we'll call it the  
15 discount as you've used the term.

16 A. My best recollection is that Mr.  
17 Fazio was either -- attended or had heard  
18 firsthand about a meeting that I know has been  
19 depicted in the prior discovery Sun -- I  
20 believe it was Sunday night before the deal  
21 was closed Monday morning, where -- and I was  
22 in the deposition of Michael Klein who  
23 acknowledged that he had a depiction of the --  
24 a very high-level depiction of the deal that  
25 was written on the back of a manila envelope

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2 that was shown to Mike and/or others at  
3 Houlihan.

4 I remember Mike telling us that  
5 they, meaning as advisors to the Unsecured  
6 Creditors Committee, had been asked -- had  
7 asked Barclays and Lehman people for the  
8 details behind the difference between the  
9 marked values and what was determined to be  
10 the negotiated value as depicted on that  
11 envelope. And they were very unhappy with the  
12 fact that they had never gotten any details.  
13 They were promised the details at the time and  
14 they never got them. And I think that was  
15 part of what was underlying their concerns  
16 about the economics of the deal.

17 Q. So they were aware of the delta  
18 but they wanted to get details about the delta  
19 further explained.

20 A. Sure. If you're a fiduciary for  
21 the estate and you're aware of that you'd like  
22 to have empirical knowledge, empirical  
23 evidence of how it was derived rather than  
24 just, you know, somebody saying it was  
25 negotiated.

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2 Q. The sale transaction didn't  
3 require the deal to be a wash, did it?

4 MR. TAMBE: Objection to form of  
5 the question.

6 A. The sale transaction didn't  
7 require the deal to be a wash?

8 Q. Okay. I'll rephrase that. Are  
9 you familiar with the term "wash"?

10 A. Yes.

11 Q. What does that term mean to you?

12 A. Well, in the context I know where  
13 you're coming from, it's assets essentially  
14 equalled liabilities. And there was little to  
15 no exchange of economic value in the deal.

16 Q. Okay. And little to no exchange  
17 of economic value, can you explain to me?

18 A. Yeah. Wash assets equal  
19 liabilities, that's how I'm trying to give my  
20 understanding of what that concept means.

21 Q. It was never your understanding  
22 there was something that sale transaction  
23 documents required that assets match  
24 liabilities; is that correct?

25 A. I don't think it was ever --

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2 MR. TAMBE: Objection to form of  
3 the question.

4 A. I don't have any basis to think it  
5 was characterized as -- in that way in the  
6 sale documents. Although I would point out  
7 that the Asset Purchase Agreement dated  
8 October 16th, and I think this is depicted in  
9 our Rule 60 papers, it really does -- the end  
10 result of that appears to be assets equal  
11 liabilities as it relates to the securities  
12 and the comp and cure obligations being  
13 assumed. And then you've got an additional  
14 element of consideration if you want to look  
15 at it that way by virtue of, you know, other  
16 liabilities being assumed.

17 Q. Have you done an analysis of the  
18 initial Asset Purchase Agreement to determine  
19 what the actual liabilities would have been  
20 and what the assets would have been?

21 A. Well, what I'm describing I think  
22 is depicted in our Rule 60(b) motion. I can  
23 picture it now. There's a little table in the  
24 motion that depicts \$70 billion of long  
25 positions, 69 billion of short positions,